VZCZCXRO8103
RR RUEHMR
DE RUEHLG #0115 0381130
ZNY CCCCC ZZH
R 071130Z FEB 06
FM AMEMBASSY LILONGWE
TO RUEHC/SECSTATE WASHDC 2330
INFO RUCNSAD/SOUTHERN AFRICAN DEVELOPMENT COMMUNITY
RUEHFR/AMEMBASSY PARIS 0083
RUEHLO/AMEMBASSY LONDON 0191
RUEATRS/DEPT OF TREASURY WASHDC 0424
RUEAIIA/CIA WASHDC

C O N F I D E N T I A L LILONGWE 000115

SIPDIS

SIPDIS

STATE FOR AF/S G. MALLORY, L. CECSARINI AND D. MOZENA
STATE FOR EB/IFD/ODF LINDA SPECHT AND ELAINE JONES
TREASURY FOR INTERNATIONAL AFFAIRS/AFRICA/BEN CUSHMAN
PARIS FOR D'ELIA

E.O. 12958: DECL: 02/06/2016
TAGS: EFIN ECON MI
SUBJECT: MALAWI'S CENTRAL BANKERS ANXIOUS ABOUT IMF MISSION

REF: A. LILONGWE 0020
¶B. LILONGWE 0037

Classified By: Econoff W. Taliaferro, for reasons 1.4 b/d

¶1. (C) Despite fiscal performance that has been described as "impressive" over the past year, Malawi's central bankers are nervous about the upcoming quarterly review from the IMF's country team. At recent visits with the Reserve Bank of Malawi's (RBM) Governor Victor Mbewe and general manager Wilson Banda, they have expressed deep worry about the February mission. The cause of their worry: Malawi's persistently tight control over foreign exchange rates, in defiance of the IMF's expressed concern that the Kwacha's price should be determined by market forces. A reportedly strong letter from IMF deputy managing director Takatoshi Kato had impressed Banda enough to ask for U.S. support in keeping the IMF from suspending its Poverty Reduction and Growth Facility.

¶2. (C) IMF resident representative Thomas Baunsgaard reassured us that no such move is being contemplated, although senior staff at the Fund is "seriously concerned" about the forex policy. He reports that the main issue is credibility, as the GOM has committed to looser forex policies for a year now but taken little action. Baunsgaard said that, while the Fund is not contemplating any delay to the next review, the review after that could be delayed if the GOM does not show progress. Embassy supports this approach. While the GOM clearly needs to be pressured, precipitate action to suspend the PRGF would endanger HIPC completion, in turn delaying the paydown of domestic debt and seriously impacting the GOM's fiscal performance.

¶3. (C) As reported earlier (ref B), forex policy is clearly being dictated from the finance ministry. Finance minister Goodall Gondwe has had plain reasons for keeping the kwacha's price high, as he has presided over massive importations of grain and fertilizer to mitigate this year's hunger crisis and perhaps avoid next year's. Now that the seasonal imports are done and the export season is about to begin, he has let the Kwacha slip again, from 125/USD to 130/USD in the past two weeks. (In another demonstration of last-minute monetary liberality, the liquidity reserve ratio for banks was abruptly lowered last week from 27.5 percent to 20. This move will probably not drive up inflation, since government securities will absorb most of the new liquidity, but its timing is odd.) While Gondwe's concern over the GOM's fiscal performance is sensible enough, the high Kwacha has been maintained at a considerable price to the private

sector. Malawi now has a large backlog of unpaid foreign currency invoices, and many providers are increasingly hesitant to ship here on credit. Add to that the RBM's questionable mechanisms for enforcing the Kwacha's inflated price (ref A), and the virtue of fiscal prudence starts to look like bullying businesses for government's benefit.

¶4. (C) COMMENT: It is reassuring to know the IMF is taking a steady-on approach while ratcheting up the pressure. When the mission gets here, Gondwe will almost certainly argue fiscal necessity, and he has a point. But because the private sector's advocates cannot face Gondwe down, the IMF has to. This entails addressing two main issues: the balance between government and private interests in monetary policy (which entails establishing some independence for the RBM so it can argue against government's narrow self-interest), and the question of informal controls (how exactly is the GOM enforcing a strong-kwacha position?). If the IMF combines a frank dialogue on these issues with a tough position on the next review, it could remove another obstacle to growth and investment.
GILMOUR